

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois-American Water Company	:	
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	:	09-0400
Petition for approval of a change in	:	
method of accounting for Pension and	:	
Other-Post Employment Benefit Costs.	:	

**REPLY BRIEF OF THE STAFF
OF THE ILLINOIS COMMERCE COMMISSION**

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January 13, 2010

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Pursuant to 83 Ill. Adm. Code 200.800, Staff of the Illinois Commerce Commission (“Staff”), by and through its undersigned attorneys, hereby files its Reply Brief in the instant proceeding. On December 31, 2009, Initial Briefs (“IB”) were filed in this matter by Illinois-American Water Company (“IAWC,” “Illinois-American” or the “Company”), the Attorney General of the State of Illinois (the “AG”), and Staff.

I. INTRODUCTION

In the instant proceeding, Illinois-American proposes to defer and amortize over five years the difference between its annual pension and other post-employment benefits (“OPEB”) expense and the amount reflected in its prior rate case, Docket No. 07-0507, of \$1,661,675. If approved by the Illinois Commerce Commission (“Commission”), IAWC would implement the proposal in its current rate case, Docket No. 09-0319. Staff continues to support the position advanced in its testimony and in its Initial Brief that the Commission should deny Illinois-American’s request to change its method of accounting for pension and OPEB costs.

Staff's Initial Brief summarizes the deficiencies of Illinois-American's proposal including: (1) the dissimilarity of pension and OPEB costs to tank painting in that tank painting is deferred because a portion of the tank painting costs benefit future periods; (2) the cost of providing service not being reflected in the same period in which that service was provided; (3) the mismatch of revenues and expenses against one another; (4) the enablement of single-issue ratemaking; (5) the violation of the Uniform System of Accounts for Water Utilities; (6) the distortion of the Company's financial statements; (7) the impairment of comparability of the Company's financial statements with those of other companies; and (8) the questionable benefit to ratepayers.

Illinois-American's Initial Brief summarizes the arguments made in its testimony, and those arguments were adequately addressed by Staff in its Initial Brief. In the interest of avoiding unnecessary duplication, Staff has not repeated every argument or response previously made in Staff's Initial Brief. Thus, the omission of a response to an argument that Staff previously addressed simply means that Staff stands on the position taken in Staff's Initial Brief. To the extent that the Company raises an argument in its Initial Brief, the absence of a response by Staff to the argument should not be construed that Staff agrees with the argument made by the Company. Staff is only addressing certain arguments raised by the Company.

Staff is in agreement with the issues raised in the AG's Initial Brief, and most issues raised were addressed in Staff's Initial Brief. Thus, Staff will address issues raised in the AG's Initial Brief only to provide additional emphasis. Thus, the omission of a response to an argument does not imply that Staff does not support that argument.

II. ARGUMENT

A. Reply to the Company

Staff notes that Illinois-American states that pension and OPEB costs “fluctuate significantly” from year to year to justify its proposal (IAWC IB, p. 2), but nowhere is significant fluctuation defined. Thus, it is not clear how large the Company believes a fluctuation must be to justify its deferral and amortization. Using only the vague rationale of “fluctuate significantly” to depart from the Commission’s test year rules would risk the same mismatching of any current period operating expense against revenues from a later period by any utility that deemed an operating expense to have significantly fluctuated. By way of contrast, tank painting is amortized for the valid purpose of recognizing the cost of tank painting over its useful life (matching the cost of tank painting with its related revenues).

Illinois-American’s Initial Brief cites the Commission’s Order in Docket No. 93-0408 as a justification for allowing normalization of expense where certain events occur with some regularity. (*Id.*, p. 6) The Company, however, fails to note that the discussion it relies upon was related to abnormal events (ice storms for example) (Order, Docket No. 93-0408, October 19, 1994, p. 12). The incurrence of pension and OPEB costs is not an abnormal event. Therefore, the Commission’s Order in Docket No. 93-0408 does not support the Company’s proposal as the Company contends.

With respect to Docket No. 98-0895, Illinois-American notes that the Y2K expenses in question were essentially one-time costs. (IAWC IB, p. 15) The Company uses this detail to attempt to distinguish the findings in Docket No. 98-0895 from the instant proceeding. The Company, however, misses the point that the Commission’s

Conclusion centered on matching expenses incurred during the test year with revenue accrued during that year and found deferral contrary to the ratemaking principle requiring that expenses be recognized in the year in which they are incurred (Order, Docket No. 98-0895, March 15, 2000).

In Docket No. 02-0690, the Company notes that the lack of prior approval, which the Company seeks in the instant proceeding, was a factor in the Commission denying deferral of security costs. (IAWC IB, p. 16) While the Commission did note the lack of prior approval in Docket No. 02-0690, it concluded that mismatching revenues and expenses is inconsistent with test year rules. (Order, Docket No. 02-0690, August 12, 2003, p. 69) In Docket No. 02-0690, the Commission also found that the security costs were ordinary operating expenses which could be recovered through rates, and that deferral was not appropriate solely because the amount of security costs had changed. (*Id.*, p. 65)

Illinois-American further claims that its proposal is consistent with Generally Accepted Accounting Principles (“GAAP”). (IAWC IB, pp. 16-19) However, as Staff has explained, the Company’s proposal would be a violation of GAAP if Illinois-American were not a rate-regulated enterprise. (ICC Staff Exhibit 2.0, p. 5; Staff IB, p. 3)

Staff also points out that the Company uses the actuarial assessment from Docket No. 07-0507 as a basis from which to calculate an incremental amount. (IAWC IB, p. 4) The Company did not offer a rationale for using the Docket No. 07-0507 actuarial assessment as a basis versus any other study or annualized amount. Thus, Staff contends that the incremental amount is an arbitrary amount.

B. Reply to the AG

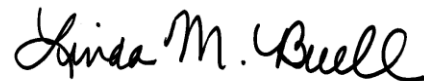
The AG correctly concludes that the Company's proposal will cost ratepayers more in the long run. (AG IB, pp. 1-2) The AG is also correct that pension and OPEB costs from 2009 in excess of the Docket No. 07-0507 actuarial assessment should not be passed on to ratepayers. (*Id.*, p. 2) This incremental amount is an expense of \$3,238,857, which was incurred prior to the 2010 test year.

The AG further concludes that the Company's proposal will result in retroactive ratemaking. (*Id.*, pp. 8-9) Staff agrees that recovering the incremental amount from 2009 would result in retroactive ratemaking by allowing the Company to recover costs incurred prior to the test year.

III. CONCLUSION

For the reasons set forth in its Initial Brief and this Reply Brief, Staff respectfully requests that the Commission deny Illinois-American's request for a change in its method of accounting for Pension and Other Post-Employment Benefit Costs in the instant proceeding in accordance with Staff's recommendations herein.

Respectfully submitted,

A handwritten signature in black ink that reads "Linda M. Buell". The signature is written in a cursive, flowing style.

LINDA M. BUELL

Counsel for the Staff of the Illinois
Commerce Commission

January 13, 2010

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